

Revised
OPEN MEETING
MEMORANDUM

TO: THE COMMISSION

FROM: Utilities Division

DATE: June 15, 2022

RE: IN THE MATTER OF THE APPLICATION OF ARIZONA PUBLIC SERVICE COMPANY FOR APPROVAL OF ITS 2022 RENEWABLE ENERGY STANDARD IMPLEMENTATION PLAN FOR RESET OF RENEWABLE ENERGY ADJUSTOR. (DOCKET NO. E-01345A-21-0240)

SUBJECT: THE SOLANA CONTRACT

INTRODUCTION

Enclosed is the Commission Staff's memorandum for the Solana Contract (Docket No. E-01345A-21-0240).

You may file comments to the memorandum by efilng at <https://efiling.azcc.gov/> or filing an original and the appropriate number of copies in accordance with the Filing Requirements available at <http://azcc.gov/hearing/docket-control-center-filing-requirements>, with the Commission's Docket Control on or before: **June 24, 2022**.

This matter may be scheduled for Commission deliberation at its Open Meetings scheduled **June 28, 2022, and June 29, 2022**.

If you have any questions about this matter, please contact Barbara Keene of our Staff at (602) 542-0853, or Elijah Abinah, Director, at (602) 542-6935.

BACKGROUND

On August 3, 2021, Chairwoman Márquez Peterson filed a letter in this Docket asking Arizona Corporation Commission ("Commission") Utilities Division Staff ("Staff") to be prepared to address at the August 17 and 18, 2021, Open Meeting whether Staff believes that the Renewable Energy Standard ("RES") budgets, surcharges, and renewable Power Purchase Agreements ("PPAs") included in the Arizona Public Service Company ("APS") 2022 RES Implementation Plan, including the Solana PPA, should be sent to an evidentiary hearing for a detailed cost and prudence review.

At the Open Meeting on August 18, 2021, Commissioners discussed APS's RES Plan and the Solana Contract with Staff, APS, Atlantica Sustainable Infrastructure ("Atlantica"), and other interested parties. The Commission directed Staff to prepare a memorandum that details the terms of the current Solana Contract and provide options concerning the Solana Contract for Commission consideration.

HISTORY OF THE SOLANA CONTRACT

On February 21, 2008, APS filed an application with the Commission for approval of a PPA with Arizona Solar One LLC, a subsidiary of Abengoa Solar Inc., to purchase the full output of a 280 Megawatt ("MW") Concentrating Solar Power ("CSP") facility ("Solana Project") over a 30-year period. The current owner of Solana is Atlantica.

On March 28, 2008, Staff met with APS to review APS's final selection and recommendation resulting from a Request for Proposal ("RFP") process. The types of resources submitted by bidders included wind, photovoltaic solar, CSP, biogas, and storage. Information was provided to Staff under a competitively confidential protection agreement. Decision No. 70531 (September 30, 2008) details that Staff reviewed APS's Renewable Energy Competitive Procurement Procedure, the RFP, a report on the matter issued by Navigant Consulting, Inc. ("NCI"),¹ discussions with APS, the quantitative and qualitative results of the selection process, and the alternative proposals available to APS. APS received 51 proposals from 28 different respondents. Staff concluded that the Solana PPA was selected through a competitive bid procurement process. Staff also reviewed potential bill impacts of the value of the Solana PPA compared to APS's projected cost of energy for a conventional resource alternative. Please see Attachment A to this document for the bill analysis.

Decision No. 70531 ordered that the Solana PPA was an appropriate component of APS's energy portfolio, was compatible with APS's RES Implementation Plan as approved in Decision No. 70313 (April 28, 2008), and would meet the requirements of an Eligible Renewable Energy Resource pursuant to Arizona Administrative Code ("A.A.C.") R14-2-1802.

In addition, Decision No. 70531 ordered that the Decision was not intended to address approval of the PPA and not intended to address the prudence of the PPA or its ratemaking treatment.

Decision No. 70531 also ordered that in any subsequent inquiry into the prudence of the PPA, the expense of renewable energy purchased under the PPA should not be deemed imprudent solely because the expense is greater than for conventional generation.

There have been multiple restatements and modifications to the original Solana Contract. These included a December 2010 modification under which the United States Department of Energy ("DOE") issued a \$1.45 billion loan guarantee to finance Solana.

¹ NCI served as the independent auditor for the process. NCI's report is in Attachment 4 to Staff's Memorandum filed on September 10, 2008, in Docket No. E-01345A-08-0106.

CONTRACT TERMS

[BEGIN CONFIDENTIAL]

[END CONFIDENTIAL]

The PPA includes provisions that mitigate harm to APS should the energy generated by the Solana facility not be available to APS for a variety of reasons. Certain provisions would require damage payments to be made to APS. [BEGIN CONFIDENTIAL]

[END CONFIDENTIAL]

There have been seven amendments to the Solana contract.

OPTIONS

- (1) Direct APS to Exit/Terminate the Contract
- (2) Direct APS to Renegotiate the Contract
- (3) Evidentiary Hearing
- (4) Take No Action
- (5) Require APS to File Future Contract Restatements and Modifications with Commission Staff for Review

Direct APS to Exit/Terminate the Contract

Under Option 1, the Commission could direct APS to exit or terminate the contract. However, APS cannot unilaterally exit the contract. Under the terms of the contract, such action would constitute a breach. Based on the terms and conditions defined in the contract, the non-defaulting party would calculate the settlement amount as of the early termination date. The amount would equal the remaining value of the contract minus any amount that Atlantica might

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be able to obtain from sales to a new counterparty, at whatever is the prevailing price. According to APS's response to Staff, the remaining payments on APS's contract are nearly \$3 billion.

If the contract were to be terminated, APS would also need to procure replacement power. APS states that Solana provides 250 MW of summer on peak capacity, and 845 Gigawatt hours ("GWH") of planned renewable energy per year, with six hours of energy storage. APS would likely use an all-source RFP procurement process, including renewables, storage, natural gas, customer resources, and demand-side management. It could take years to arrange for the replacement power and could result in significant additional costs. If APS were to breach a contract, developers might consider APS to be a risky counterparty and therefore increase the cost of future projects for APS. APS expects that the replacement power might not be available to serve summer load until 2025.

[BEGIN CONFIDENTIAL]



[END CONFIDENTIAL]


Direct APS to Renegotiate the Contract

Under Option 2, although the Commission might want the parties to renegotiate the Solana Contract, that does not appear to be an option. At the August 18, 2021, Commission Open Meeting, Mr. Fred Redell, Managing Director of Atlantica, was asked whether Atlantica would be willing to renegotiate its contract with APS. Mr. Redell responded that renegotiation would not be considered because the contract supports all of the investment that was put into the project when it was originally conceived and constructed.

[BEGIN CONFIDENTIAL]



²



³

[END CONFIDENTIAL]

In addition, because Solana is financed, in part, through a DOE loan guarantee, DOE would need to agree to any material modifications to the contract.

[BEGIN CONFIDENTIAL]

[END CONFIDENTIAL]

Evidentiary Hearing

A third option would be for the Commission to hold an evidentiary hearing regarding the Solana Contract. A.A.C. R14-2-1813(C) provides that “[t]he Commission may hold a hearing to determine whether an Affected Utility’s implementation plan satisfies the requirements of these rules.” However, Staff believes that the RES docket is not the place for a prudency determination. Prudency should be determined in the context of a rate case, where Staff and the Commission have the benefit of a complete evidentiary record. An evidentiary hearing may not result in a different outcome because the Commission does not have the right to change the terms and conditions of a contract negotiated by two parties. An evidentiary hearing might lead to an additional regulatory challenge such as retroactivity.

Furthermore, one should consider what is involved in a prudency determination. Typically, it includes a presumption that the utility’s decisions are prudent. A.A.C. R14-2-103(A)(3)(I) defines the term “Prudently invested” as:

Investments which under ordinary circumstances would be deemed reasonable and not dishonest or obviously wasteful. All investments shall be presumed to have been prudently made, and such presumptions may be set aside only by clear and convincing evidence that such investments were imprudent, when viewed in the light of all relevant conditions known or which in the exercise of reasonable judgment should have been known, at the time such investments were made.

It is important to evaluate a utility’s decision under the circumstances that were known or could have been known at the time the decision was made. Hindsight should not be used. For example, a prudence determination of a renewable resource should consider the costs of options at the time of the utility’s decision to obtain the resource, but not at today’s costs to obtain the resource.

Take No Action

Under Option 4, the Commission would take no action at this time. In 2008, Commission Decision No. 70531 ordered that the Solana PPA was an appropriate component of APS's energy portfolio. There have already been four rate case decisions⁴ for APS since 2008. While the contract price for solar under the Solana PPA may be higher than market value today, the prudence of the investment must be analyzed at the time the investment was made. Decision No. 70531 specifically stated that it did not address the prudence of the PPA or its ratemaking treatment. However, Staff believes prudence should be evaluated in the context of a rate case.

[BEGIN CONFIDENTIAL]



[END CONFIDENTIAL]

Require APS to File Future Contract Restatements and Modifications with Commission Staff for Review

Under Option 5, the Commission could require APS to file all future contract restatements and amendments with Commission Staff for review. This option recognizes that the prudence is based upon the circumstances at the time investment is made. However, subsequent modifications may necessitate reevaluation by the Commission.

Based on the foregoing, the Commission could require APS to file all future contract restatements and modifications with Commission Staff for review.

SUMMARY

Pursuant to the Commission's directive at the August 17 and 18, 2021 Open Meeting, Staff was instructed to bring back options, not a recommendation; however, Staff is willing and able to make its recommendation at the appropriate time.

Below are the options Staff identified for the Commission's consideration:

⁴ Decision No. 71448 (December 30, 2009), Decision No. 73183 (May 24, 2012), Decision No. 76295 (August 18, 2017), Decision No. 78317 (November 9, 2021).

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- Direct APS to Exit/Terminate the Contract
- Direct APS to Renegotiate the Contract
- Evidentiary Hearing
- Take No Action
- Require APS to File Future Contract Restatements and Modifications with Commission Staff for Review

A handwritten signature in purple ink, appearing to read "E. O. Abinah".

Elijah O. Abinah
Director, Utilities Division

EOA:BK:elr\MAS

ORIGINATOR: Barbara Keene

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On this 15th day of June, 2022, the foregoing document was filed with Docket Control as a Utilities Division Memorandum & Proposed Order, and copies of the foregoing were mailed on behalf of the Utilities Division to the following who have not consented to email service. On this date or as soon as possible thereafter, the Commission's eDocket program will automatically email a link to the foregoing to the following who have consented to email service.

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ATTACHMENT A

Typical Bill Analysis

The following table demonstrates the bill impact to customers that would result from approval of the PPA in years 2012, 2016, and 2021. The pricing in this table assumes the ITC is approved in 2008 at a 30 percent level. In this table, residential customer impact is calculated having combined the E-10, E-12, and ET-1 customer classes. Residential customers in the E-10, E-12, and ET-1 classes collectively account for over 90 percent of all of APS' residential customers. For commercial and industrial customers less than 3 MW, the E-32 rate class was used. It accounts for over 93 percent of all small commercial and industrial customers. For commercial and industrial customers with demand greater than 3 MW, a combination of the E-34 and E-35 customer classes were used. These account for 100 percent of all large commercial and industrial customers. Note that the table includes bill impacts for both median and average customer kWh consumption. Also note that bill impact is described by both dollar increase and the increase as a percentage of the total bill.

Table I

Arizona Public Service Company
REST - Solana Base Purchased Power Agreement Bill Impacts
Residential, Small C/I and Large C/I Customer Classes

	2012 - 1st Full Year	2016 - 5th Year	2021 - 10th Year
<i>REST - Solana Above Market Costs¹</i>			
<i>Annual REST Collection by Class²</i>			
Residential			
Small C/I			
Large C/I			
Total			
<i>Increase in REST Charge and Caps³</i>			
per kWh	\$0.003155	\$0.002722	\$0.002362
Residential Cap	\$1.28	\$1.09	\$0.94
Small C/I Cap	\$45.96	\$40.45	\$35.10
Large C/I Cap	\$108.90	\$121.34	\$105.30

**REST Monthly Bill Impact \$
on Average Customer by Rate¹**

E-10 / E-12 / ET-1	\$1.28	\$1.09	\$0.94
E-32	\$27.19	\$23.46	\$20.36
E-34 / E-35	\$108.90	\$105.30	\$105.30

**REST Monthly Bill Impact %
on Average Customer by Rate¹**

E-10 / E-12	1.09%	0.93%	0.80%
E-32	3.44%	2.97%	2.57%
E-34 / E-35	0.04%	0.05%	0.04%

**REST Monthly Bill Impact \$
on Median Customer by Rate⁵**

E-10 / E-12 / ET-1	\$1.28	\$1.09	\$0.94
E-32	\$3.93	\$3.39	\$2.94
E-34 / E-35	\$108.90	\$121.34	\$105.30

**REST Monthly Bill Impact %
on Median Customer by Rate⁵**

E-10 / E-12	1.10%	0.94%	0.81%
E-32	0.50%	0.43%	0.37%
E-34 / E-35	0.04%	0.05%	0.04%

¹ Amount reflected is portion above market costs, which is not reflected in the PSA.

² The collection by class corresponds with the proportionality requirement set in Paragraph 63 of the Settlement Agreement approved by A.C.C. Decision No 67744. The kWh charge and caps have been raised proportionally.

³ The compounded customer growth rate used in the calculation of the REST charge for the 9 year period (2012 - 2021) is 2.5%. The current REST energy rate and caps are: \$0.003288 per kWh, a \$1.32 cap for Residential, a \$48.84 cap for Small C&I, and a \$146.53 cap for Large C&I.

⁴ E-10 / E-12 / ET-1 avg. monthly kWh usage is 1,022 kWh. E-32 avg. monthly kWh usage is 8,619 kWh. E-34 / E-35 avg monthly kWh usage is 3,286,589 kWh.

Average and median usage is for 12 month ending September 2007.

⁵ E-10 / E-12 / ET-1 median monthly kWh usage is 875 kWh. E-32 median monthly kWh usage is 1,245 kWh. E-34 / E-35 median monthly kWh usage is 2,335,000 kWh.

Average and median usage is for 12 month ending September 2007.

Table II contains the same information as Table I except that it assumes a circumstance where the ITC is approved in June of 2009 with a 30 percent tax credit. The scenario represents the latest period for approval of the ITC contemplated by Schedule II.

Table II

Arizona Public Service Company
REST - Solana Purchased Power Agreement Bill Impacts
Delay in ITC Extension Percentage [REDACTED]
Residential, Small C/I and Large C/I Customer Classes

	2012 - 1st Full Year	2016 - 5th Year	2021 - 10th Year
REST - Solana Above Market Costs¹	[REDACTED]		
Annual REST Collection by Class²			
Residential			
Small C/I			
Large C/I			
Total			
Increase in REST Charge and Caps³			
per kWh	\$0.003487	\$0.003038	\$0.002663
Residential Cap	\$1.39	\$1.22	\$1.07
Small C/I Cap	\$51.81	\$45.13	\$39.56
Large C/I Cap	\$155.44	\$135.39	\$118.68
REST Monthly Bill Impact \$ on Average Customer by Rate⁴			
E-10 / E-12 / ET-1	\$1.39	\$1.22	\$1.07
E-32	\$30.05	\$26.18	\$22.95
E-34 / E-35	\$155.44	\$118.68	\$118.68
REST Monthly Bill Impact % on Average Customer by Rate⁴			
E-10 / E-12	1.20%	1.05%	0.92%
E-32	3.81%	3.32%	2.91%
E-34 / E-35	0.06%	0.06%	0.05%
REST Monthly Bill Impact \$ on Median Customer by Rate⁵			
E-10 / E-12 / ET-1	\$1.39	\$1.22	\$1.07
E-32	\$4.34	\$3.78	\$3.31
E-34 / E-35	\$155.44	\$135.39	\$118.68

**REST Monthly Bill Impact %
on Median Customer by Rate⁵**

E-10 / E-12	1.21%	1.06%	0.93%
E-32	0.55%	0.48%	0.42%
E-34 / E-35	0.06%	0.05%	0.05%

¹ Amount reflected is portion above market costs, which is not reflected in the PSA.

² The collection by class corresponds with the proportionality requirement set in Paragraph 63 of the Settlement Agreement approved by A.C.C. Decision No 67744. The kWh charge and caps have been raised proportionally.

³ The compounded customer growth rate used in the calculation of the REST charge for the 9 year period (2012 - 2021) is 2.5%. The current REST energy rate and caps are: \$0.003288 per kWh, a \$1.32 cap for Residential, a \$48.84 cap for Small C&I, and a \$146.53 cap for Large C&I.

⁴ E-10 / E-12 / ET-1 avg. monthly kWh usage is 1,022 kWh. E-32 avg. monthly kWh usage is 8,619 kWh. E-34 / E-35 avg monthly kWh usage is 3,286,589 kWh.

Average and median usage is for 12 month ending September 2007.

⁵ E-10 / E-12 / ET-1 median monthly kWh usage is 875 kWh. E-32 median monthly kWh usage is 1,245 kWh. E-34 / E-35 median monthly kWh usage is 2,335,000 kWh.

Average and median usage is for 12 month ending September 2007.

Table III contains the same information as Table I and Table II except that it assumes a circumstance where the ITC is approved in June of 2009 with a 10 percent tax credit. The scenario represents the latest period for approval of the ITC contemplated by Schedule II combined with the lowest percentage of ITC contemplated by Schedule III. It is the most costly potential price combination that could occur.

Table III

Arizona Public Service Company

REST - Solana Purchased Power Agreement Bill Impacts

Delay in ITC Extension and Variance in ITC

Percentage

Residential, Small C/I and Large C/I Customer Classes

	2012 - 1st Full Year	2016 - 5th Year	2021 - 10th Year
REST - Solana Above Market Costs¹			
Annual REST Collection by Class²			
Residential			
Small C/I			
Large C/I			
Total			

Increase in REST Charge and Caps³

per kWh	\$0.005437	\$0.004913	\$0.004486
Residential Cap	\$2.17	\$1.97	\$1.79
Small C/I Cap	\$80.78	\$72.99	\$66.64
Large C/I Cap	\$242.33	\$218.96	\$199.93

***REST Monthly Bill Impact \$
on Average Customer by Rate⁴***

E-10 / E-12 / ET-1	\$2.17	\$1.97	\$1.79
E-32	\$46.86	\$42.34	\$38.66
E-34 / E-35	\$242.33	\$218.96	\$199.93

***REST Monthly Bill Impact %
on Average Customer by Rate⁴***

E-10 / E-12	1.87%	1.70%	1.54%
E-32	5.93%	5.36%	4.90%
E-34 / E-35	0.10%	0.09%	0.08%

***REST Monthly Bill Impact \$
on Median Customer by Rate⁵***

E-10 / E-12 / ET-1	\$2.17	\$1.97	\$1.79
E-32	\$6.77	\$6.11	\$5.58
E-34 / E-35	\$242.33	\$218.96	\$199.93

***REST Monthly Bill Impact %
on Median Customer by Rate⁵***

E-10 / E-12	1.89%	1.71%	1.56%
E-32	0.86%	0.77%	0.70%
E-34 / E-35	0.09%	0.08%	0.08%

¹ Amount reflected is portion above market costs, which is not reflected in the PSA.

² The collection by class corresponds with the proportionality requirement set in Paragraph 63 of the Settlement Agreement approved by A.C.C. Decision No 67744. The kWh charge and caps have been raised proportionally.

³ The compounded customer growth rate used in the calculation of the REST charge for the 9 year period (2012 - 2021) is 2.5%. The current REST energy rate and caps are: \$0.003288 per kWh, a \$1.32 cap for Residential, a \$48.84 cap for Small C&I, and a \$146.53 cap for Large C&I.

⁴ E-10 / E-12 / ET-1 avg. monthly kWh usage is 1,022 kWh. E-32 avg. monthly kWh usage is 8,619 kWh. E-34 / E-35 avg monthly kWh usage is 3,286,589 kWh.

Average and median usage is for 12 month ending September 2007.

⁵ E-10 / E-12 / ET-1 median monthly kWh usage is 875 kWh. E-32 median monthly kWh usage is 1,245 kWh. E-34 / E-35 median monthly kWh usage is 2,335,000 kWh.

Average and median usage is for 12 month ending September 2007.